



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Internal Audit Report for November 2020

Summary

Two reports were issued during the month:

- 1. Colorado River Water Users Association Financial Report for the period April 1, 2019, through March 31, 2020**
- 2. Check with Order Audit Report**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during November 2020. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examination is also provided.

Colorado River Water Users Association Financial Report for the period April 1, 2019, through March 31, 2020

At the request of the Metropolitan Water District of Southern California Board of Directors, we examined the Colorado River Water Users Association Financial Report for the period April 1, 2019, through March 31, 2020. The following summarizes the scope of work performed and results obtained:

Scope and Purpose

We performed the following procedures to gain reasonable assurance that information included in the Colorado River Water Users Financial Report for the period April 1, 2019, through March 31, 2020, is accurate and is supported by appropriate documentation:

- We agreed information from the Financial Report to source documentation, including bank statements and receipts.
- We confirmed a sample of transactions with third parties.
- We examined monthly bank reconciliations and assessed the reasonableness of reconciling items and the accuracy of balances.

As our examination is limited in scope, we do not express an opinion on the internal control structure over the Colorado River Water Users Association taken as a whole.

Background

The Colorado River Water Users Association (CRWUA) was founded in 1945 and incorporated in the State of Nevada on December 6, 1968. Its mission is to provide a forum for exchanging ideas and perspectives on Colorado River use and management with the intent of developing and advocating common objectives, initiatives, and solutions.

From April 1, 2019, through March 31, 2020, CRWUA reported total receipts of \$495,555 and total disbursements of \$293,324. As of March 31, 2020, CRWUA's total fund available was \$807,727.

Testing results

We noted expenses decreased by 41% from \$495,323 last year to \$293,325 this year, mainly due to reduced conference costs. Our examination did not reveal any material differences between the reported amounts and supporting documentation.

Check with Order Audit Report

The Audit Department has completed a review of the accounting and administrative controls over the Check with Order Process as of June 30, 2020.

Scope

Our review consisted of an evaluation of the internal controls over the initiation, authorization, payment, and distribution of accounts payable transactions classified as "Check with Order" (CWO). These transactions occur when an employee requests the return of a signed check for manual delivery to the payee or when a vendor asks to pick-up their payment from the treasury operation team. We reviewed documentation supporting each request, ensuring that the expenditure was vouched against deliverables, appropriately approved, and released to an authorized employee. We also evaluated physical controls over access to the vault room and check stock for propriety. Finally, we evaluated review and approval controls for compliance with sound segregation of duties practices. Our testing consisted of extensive selections from the fiscal year 2018-19 and limited testing for 2019-20.

Background

Total disbursements by transaction type for the past two fiscal years:

Transaction type	Number of items	FY 2018/19		FY 2019/20	
		Amount	Number of items	Amount	Number of items
Checks	19,669	263,590,764	18,210	333,497,621	
EFT's	1,081	1,084,259,573	1,076	1,302,417,490	

Totals	20,750	1,347,850,337	19,286	1,635,915,111
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Of the disbursements made by checks:

- In the Fiscal year 2018/19, 1,426 items were classified as CWO for a total of \$31.8 million.
- In the Fiscal year 2019/20, 1,070 items were classified as CWO for a total of \$27.2 million.

Opinion

In our opinion, the accounting and administrative procedures over the Check with Order Process provide for a less than satisfactory internal control structure. This opinion results from the excessive use of the practice of returning signed checks (negotiable instruments) to employees and the corresponding undue risk it places upon Metropolitan, and its employees. Moreover, this practice increases the possibility that checks may be altered or delivered to an unauthorized party. Finally, this opinion is also the result of increased risk from inaccurate vendor master files and insufficient controls over the vault room.

Comments and Recommendations

CHECK WITH ORDER - RETURNING SIGNED CHECKS TO REQUESTORS

Check with Order (CWO) occurs when an employee requests the return of an accounts payable check for manual delivery to a payee. These transactions also happen when a vendor asks for the pick-up of payment from the Treasurer Operations Team. In these instances, staff should verify that an approved purchase requisition or work order has been initiated and updates the Oracle system for the revised delivery instructions. The employee or authorized agent signs to acknowledge receipt of the check. In all instances, staff should ensure that the same individual did not initiate, approve, and receive a CWO transaction. This process serves to ensure that the expenditure was vouched against deliverables/accrued liability, appropriately approved, and released to an authorized employee/agent.

During our audit, we noted the excessive use of this alternate payment process. The practice of returning signed checks (negotiable instruments) to employees increases the risk that those checks might be altered or delivered to an unauthorized party, placing unnecessary risk upon Metropolitan and its employees.

We recommend that management limit the use of CWO processing to those occasions where the payment must be tendered concurrent with the contracted services provided. In all other instances, signed checks should be mailed directly to the payee. If mailing is not feasible, the treasury team should not release the item to the same employee who initiated and approved the transaction. Finally, we recommend the Chief Financial Officer and the Chief Administrative Officer develop policies and procedures to reduce the utilization of the Check With Oder process.

We also noted Metropolitan's ongoing dependence upon printing accounts payable checks. Shifting to payment via Automated Clearing House (ACH) decreases the risk associated with altered or misappropriated checks. Additionally, ACH payments may lower transaction costs, are operationally more efficient and, are environmentally friendly.

ACCESS CONTROLS: PHYSICAL AND LOGICAL

Access controls should be established to protect against the unauthorized use, disclosure, modification, or destruction of computer-stored data. A combination of physical and logical access controls serves to achieve this control objective. Physical access control restricts entry to each facility, limiting entrance to rooms, buildings, and physical IT assets. Also, physical access controls provided recordation of access to restricted areas. Logical access control involves authenticating and authorizing users. Whereas physical access control uses keys and badges, logical controls use advanced password standards and sophisticated biometric security features. These elements identify the employee. The system then determines whether the employee has appropriate authorization to access data.

Staff duties and responsibilities should define the boundaries of the physical and logical access granted. Finally, management should conduct periodic reviews and updating of access authorities.

During our audit of the physical access to the accounts payable vault room and the check print application Secure 32 Enterprise Edition (EE), we noted:

- One hundred sixty-nine people have physical access to the vault room:
 - 137 third-party security providers
 - 26 Metropolitan employees
 - Six fire department personnel

Of the 26 Metropolitan employees with access, only five were treasury staff, and five were security management.

Subsequent to our review of the access, Treasury restricted vault access to six individuals and is considering further restrictions.

Failure to maintain access controls could result in the unauthorized use, disclosure, modification, or destruction of computer-stored data.

We recommend that the CFO organization maintain authority over access to the vault, evaluate physical access controls, and reconcile these settings against staff duties and responsibilities. We also recommend management perform periodic access reviews. We understand management has begun reviewing these procedures.

VENDOR MASTERFILE MAINTENANCE

The Vendor Master File (master file) is the repository for essential information about vendors and is critical to effective internal control over the procurement and accounts payable functions. Adequately controlled, the master file ensures properly segregated duties, use of authorized vendors, accurate cash disbursements, and proper tax reporting.

We tested 56 CWO payments and found four checks for which the vendor address did not match the “remit to” address in the master file. Further analysis of 4,408 active vendors in the master file as of January 31, 2020, disclosed 105 that did not include an address and 1,389 with missing tax ID fields.

Incomplete or outdated vendor records could result in erroneous payments and inaccurate or incomplete reporting.

Since our FY 2016/17 audit of Accounts Payable, Contracting Services made significant progress in managing the vendor master file, reducing the number of active vendors by more than half. We recommend that Finance and Administration management collaborate to update the vendor master file and conduct periodic reviews.



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Date: November 19, 2020

To: Gerald C. Riss, General Auditor

From: Shane Chapman, Chief Administrative Officer
Katano Kasaine, Chief Financial Officer

Subject: Response to review of the accounting and administrative controls over the Check with Order Process as of June 30, 2020

Thank you for the Audit Department's review of the accounting and administrative controls over the Check With Order (CWO) process. Your findings and recommendations provided valuable insight for further improvements on the processes cited within the scope of the audit.

We generally concur with your recommendations with a specific qualification on shifting to payment via Automated Clearing House (ACH) as noted in the attached Summary of Findings and Recommendations matrix (Attachment I). Please note that we have already implemented corrective measures on access controls and are fully committed to making additional improvements.

We appreciate your efforts and the valuable information contained in your report.

Please feel free to contact us if you have any questions.

Shane Chapman

Katano Kasaine

Attachments (1)

ATTACHMENT (1)
The Metropolitan Water District of Southern California
Summary of Findings and Recommendations for the
Report on Check With Order Process Audit dated June 30, 2020

Findings and Recommendations	Response	Responsible Party	Completion Date
<p><u>CHECK WITH ORDER (CWO) PROCESS</u> We recommend the Chief Financial Officer and the Chief Administrative Officer work together to develop procedures to reduce the utilization of the check with the order process.</p> <p><u>Use of ACH for all Check</u> We also noted Metropolitan’s ongoing dependence upon printing accounts payable checks. Shifting to payment via Automated Clearing House (ACH) decreases the risk associated with altered or misappropriated checks. Additionally, ACH payments lower transaction costs, are operationally more efficient and, are environmentally friendly.</p>	<p>Concur. We agree that there should be a policy change that will eliminate or reduce CWO. CFO and CAO will develop process changes to determine the appropriateness of using CWO as a delivery method for future requisitions.</p> <p>Partially concur: Due to the increasing cybercriminals targeting online business activities with sophisticated tools and techniques, it is riskier for Metropolitan to process all checks via ACH. Additionally, in order to minimize exposure to fraud, Account Validation is required. Unfortunately, this product is not commercially available. Therefore, Treasury staff will have no way of validating the account before accepting to initiate the ACH process. Treasury will continue to use ACH payment to trusted vendors and continue monitoring different enhanced bank products for efficient and cost-effective ways to process checks. In addition, the risk associated with altered or misappropriated checks can be mitigated by the Check Positive Pay service, which has proven to be very effective. Lastly, we do not believe that eliminating checks will reduce cost since the same staff will continue to perform the same level of reconciliation with the ACH process.</p>	<p>CAO/CFO</p> <p>CFO</p>	<p>January 31, 2021</p>

Findings and Recommendations	Response	Responsible Party	Completion Date
<p><u>ACCESS CONTROLS: PHYSICAL AND LOGICAL</u> We recommend that the CFO organization maintain authority over access to the vault, evaluate physical access controls, and reconcile these settings against staff duties and responsibilities. We also recommend management perform periodic access reviews. We understand management has begun reviewing these procedures.</p>	<p>Concur. Currently, the control of the Vault access is with the CAO Security team. CFO office agrees that access and sound control over physical and login access to the Treasury vault while complying with the government codes for security and emergency should be maintained. Currently, the Treasury vault access has been limited to the Treasurer with four Treasury staff as well as two Security managers.</p>	<p>CAO/CFO</p>	<p>Complete</p>
<p><u>VENDOR MASTERFILE MAINTENANCE</u> We recommend that management update the vendor master file and conduct periodic reviews.</p>	<p>Concur. Contracting Services will review the vendor master file and deactivate vendors as required and update any missing taxpayer-identification numbers and addresses as necessary. Additionally, Contracting Services will assess the need to increase the frequency of its periodic reviews.</p>	<p>CAO</p>	<p>Ongoing</p>